



THE NEW 403(B) REGULATIONS: UNDERSTANDING THE ERISA EXEMPTION

Are You or Aren't You? Should You or Shouldn't You?

THE NEW REGULATIONS PRESENT SPECIAL CHALLENGES FOR TRADITIONAL DEFERRAL-ONLY 403(B) PLANS THAT HAVE NOT HISTORICALLY BEEN SUBJECT TO ERISA. FOR THE FIRST TIME, MANY EMPLOYERS ARE FINDING THAT THEY MUST ADMINISTER A PLAN THAT THEY DID NOT DESIGN, AND DEAL WITH VENDORS THAT THEY DID NOT AFFIRMATIVELY SELECT. NOT ONLY MUST THEY FORMULATE A PLAN DOCUMENT THAT ENCOMPASSES ALL THEIR VENDOR RELATIONSHIPS, BUT THEY ARE ALSO REQUIRED TO COORDINATE AMONG THE DIFFERENT VENDORS TO ENSURE THAT THE PROVISIONS OF THE DOCUMENT ARE ENFORCED. THEY MUST ALSO DO THESE THINGS WITHOUT STEPPING OVER THE MAGICAL LINE THAT MAKES THE PLAN SUBJECT TO THE RULES AND RESPONSIBILITIES OF ERISA. TO MAINTAIN THEIR ERISA EXEMPTION, THEY MUST ADMINISTER AND COORDINATE WITHOUT BECOMING THE PLAN SPONSOR.

WHERE IS THAT MAGICAL LINE AND WHEN HAVE YOU CROSSED IT? IF YOU HAVEN'T ALREADY DONE SO, SHOULD YOU GO AHEAD AND STEP ACROSS? GIVEN THE COMPLEXITY OF THE NEW REGULATIONS AND THE "FACTS AND CIRCUMSTANCES" NATURE OF THE ERISA DETERMINATION, UNWITTINGLY BECOMING AN ERISA PLAN IS A REAL CONCERN FOR MANY EMPLOYERS. UNDERSTANDING THE TIPPING POINTS AS WELL AS THE COSTS AND BENEFITS OF BECOMING AN ERISA PLAN, WILL HELP YOU TO MAKE AN AFFIRMATIVE CHOICE THAT IS RIGHT FOR YOUR ORGANIZATION.

Any tax advice contained in this communication (including any attachments) is neither intended nor written to be used, and cannot be used, to avoid penalties under the Internal Revenue Code or to promote, market or recommend to anyone a transaction or matter addressed herein.

©2008 Capital Retirement Plan Services, Inc. This bulletin is published as a general informational source. This information is general in nature and is not intended to constitute legal advice in any particular matter. Capital Retirement Plan Services, Inc. does not warrant and is not responsible for errors or omissions in the content of this report.

The ERISA Exemption

Field Assistance Bulletin (FAB) No. 2007-02 is required reading for any organization that hopes to maintain their non-ERISA status in our brave new 403(b) world.* This document was issued by the Department of Labor (DOL) in response to concerns that employers could not maintain their ERISA exemption and still comply with the new regulations. FAB 2007-02 makes clear that the DOL at least believes that plan sponsors can do both – maintain their ERISA exemption and comply with the new regulations. However, even after reading this document carefully, you may still be scratching your head – am I or aren't I?

ERISA (the Employee Retirement Income Securities Act of 1974) outlines the duties and responsibilities borne by organizations and companies that establish or maintain an employee benefit pension plan. An employer is subject to the terms of ERISA if they establish or maintain a plan. Determining whether you do in fact sponsor a plan or are instead simply making a retirement savings vehicle available to your employees is the key question. To be exempt from ERISA, a plan must satisfy all of the following requirements:

- employee participation is completely voluntary;
- employees and their beneficiaries can directly enforce their rights under the contract;
- the employer must not receive any compensation for its involvement other than reasonable expense reimbursement; and
- the employer must have limited involvement in plan operation.

A Slippery Slope

Historically, these requirements were fairly straightforward. So long as the employer did not make employer contributions to the plan, they felt comfortable that they satisfied the limited involvement requirement and were exempt from ERISA. The new regulations that require a significantly larger role for all employers, however, make the requirement for limited employer involvement more problematic. To satisfy the limited involvement requirement, the employer must not exercise any discretion or control over the plan. In theory, this makes perfect sense – the employer can't act with discretion because the plan is not the employer's plan. However, in practice this can be problematic as employers will increasingly act as the middle-man between the vendor and the employee. Further, a number of your staff may interact with employees and vendors and may not be fully aware of the rules. What are some simple guidelines that may help you navigate a complex and potentially dangerous situation?

1. **Provide only information.** Vendors need information that you have about employee deductions, compensation, status, and holdings with other vendors in order to operate the plan and enforce participant contracts. You need vendors to have this information because if they do not, their mistakes can have adverse tax consequences for both you and your employees. However, be sure to instruct your employees to only transmit information and NOT to provide advice or make recommendations. For example, you can (and should) provide the vendor the information necessary for the vendor to determine if a participant is eligible for a loan or qualifies for a hardship distribution. But you should not authorize the loan or opine about the participant's creditworthiness (as this involves discretion) if you want to retain your ERISA exemption.

* Church's plans and plans sponsored by governmental organizations are automatically exempt from ERISA. Accordingly, the only 403(b) plans that can be subject to ERISA are plans sponsored by tax-exempt organizations other than churches.

2. **Provide vendor choice and let vendors choose.** To maintain limited involvement in the plan, you must also be very careful in your relationship with plan vendors. In short, they are not your vendors and their contract is not with you. If you attempt to negotiate the terms of their products or otherwise improve their service offering, you tread into dangerous territory. Further, be sure to provide your employees with a choice of vendors. The regulations require that employers must make available investment products to a “number and selection which is designed to afford employees a reasonable choice in light of all relevant circumstances” (DOL Reg. 2510.3-2(f)). While it may be possible maintain your exemption if you only allow employees to choose from one vendor’s products, many experts believe that a minimum of 2 vendors (and probably more) is required to provide the necessary selection.

Should You or Shouldn’t You

Many plan sponsors have embraced ERISA due to their concern that they will inadvertently slip down the slope into ERISA, and their frustration over high expenses or poor service.

To make an informed decision, you need to understand what it means to be subject to ERISA and what you give up by trying to maintain the ERISA exemption.

ERISA Requirements

If you do decide to embrace ERISA, your plan will be subject to additional legal requirements, which would otherwise not apply to your plan. ERISA plans must meet:

1. ERISA’s eligibility requirements;
2. ERISA’s vesting requirement;
3. Joint and survivor annuity rules;
4. Reporting and disclosure requirements, including filing Form 5500 and providing a Summary Plan Description to participants; and
5. ERISA’s fiduciary rules, including the prohibited transaction rules.

While the first 3 requirements are unremarkable for most plans, the reporting requirements (#4) and fiduciary duties (#5) are more meaningful as they can increase your administrative burden and potential liability.

Form 5500 filing rules for 403(b) plans will now mirror 401(k) filing rules, which will mean that each plan must provide a financial accounting of the plan for the first time.

The fiduciary rules require plan sponsors to take responsibility for the fund lineup by maintaining an Investment Policy Statement and by regularly monitoring and reviewing the plan’s investment menu. More generally, the fiduciary rules require the plan sponsor to always act in the best interests of the plan participants. While these additional requirements can mean additional responsibility, with the right provider (see *The New 403(b) Regulations: Finding The Right Provider*), complying with these additional requirements may not be as difficult as you think.



Be A Plan Sponsor

While it would be nice to avoid these additional requirements if all things were equal, all things are never equal. When you choose not to sponsor a plan, you also lose control of your plan. Here are the top 5 reasons to bite the bullet and admit that it's your plan:

1. **You may become an ERISA plan without knowing it.** The new regulations significantly increase your involvement with the plan, from adopting a plan document to monitoring tax compliance defects to coordinating information between vendors. This increased involvement makes it trickier to dance the line between too much and too little involvement. If you inadvertently step over the line, you will be subject to the requirements of ERISA, but you may not know it or have prepared for it.
2. **Non-ERISA plans must allow their employees to choose among multiple vendors.** Having multiple vendors significantly increases your administrative burden. Not only are you remitting to a number of different companies payroll after payroll, but the new regulations require that you act as the middleman (or hire someone to act as the middleman) between the vendors. ERISA plans, in contrast, can enjoy the administrative ease of one full-service, single-source provider.
3. **Individual annuity contracts are expensive and restrictive.** Because individuals are purchasing contracts on an individual basis, you are not able to leverage your plan assets to negotiate better rates for your employees.
4. **You are not able to make employer contributions to the plan.** You may think that you don't want to. However, IRS regulations provide for a considerable amount of flexibility as to how employer contributions are allocated to plan participants. A good plan design will show you how employer contributions can be an integral and cost-effective element of a strategic compensation package for your employees.
5. **If it's not your plan, you can't get credit for it.** Make your 403(b) part of your benefits package. If you do assume responsibility for the plan, you can ensure that it is a good plan and is a valuable benefit you can provide to your employees. You can select the provider, negotiate better fees, and choose an investment menu that offers your employees a real opportunity to save for retirement. By taking responsibility, you also earn the credit.

MANY EMPLOYERS ARE FINDING THAT THE EFFORT IT TAKES TO AVOID ERISA EXPOSURE FOR THEIR 403(B) PLAN JUST ISN'T WORTH IT. WITH THE RIGHT PROVIDER, EMBRACING ERISA CAN ALLOW YOU TO BUILD A PLAN DESIGNED TO SERVE YOUR ORGANIZATION AND YOUR EMPLOYEES.

